



Action for Economic Reform



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## PRIVATE SECTOR PARTICIPATION IN PUBLIC INFRASTRUCTURE

### Policy Note No. 4: Results of Consultation Dialogues of Ateneo-EPRA Project with Non-Government Organizations (NGOs)<sup>1</sup>

For development to take place, public infrastructure is necessary. However, if government were solely depended upon to provide such infrastructure, the undertaking may be impeded by the lack of fiscal resources.

Given that private sector participation in the provision of more efficient and better-quality public infrastructure appears to be the more viable if not imperative option, on 24 February and 14 March 2006, the Economic Policy Reform and Advocacy project (EPRA) conducted round table discussions on “How to Ensure the Success of Private Sector Participation in Public Infrastructure Development.” The forums which focused on amendments to the BOT law and strove to obtain feedback on private sector participation (PSP) in public infrastructure were attended by representatives of non-government organizations (NGOs) and civil society organizations (CSOs), respectively. Also represented in both discussions was government, particularly the BOT and the BOI.

The stakeholders in the PSP/BOT Program are government agencies (NGAs, GOCCs and LGUs); regulatory bodies (DENR/Environmental Management Bureau, Board of Investments et al.); private proponent/investors and others (LWUA, DOF,

COP, DBM, DILG, BOT Center). Also counted among the stakeholders are the approving authorities (President of the Philippines, the NEDA Board, the Investment Coordination Committee (ICC), and Local Development Councils/Local Sanggunian), as applicable:

AMOUNT OF CONTRACT	APPROVING AUTHORITY
PhP 20M and below	Municipal Development Council
PhP 20 – 50 M	Provincial Development Council
Up to PhP 50M	City Development Council
PhP 50 – 200 M	Regional Development Council
Above PhP 200M and all negotiated contracts	NEDA – ICC
All projects undertaken through BOO and variants not specified in the Law	Office of the President

PSP projects are undertaken at both the national and LGU levels. At the national level, the implementing agencies are the national line agencies. Examples of PSP projects at this level are rail projects, water utilities, and ports modernization. Among LGUs, on the other hand, PSP projects include public markets, bus terminals, property development (buildings, airports and passenger terminals) and the computerization of local government operations.

## SOLICITED VS UNSOLICITED PROPOSALS AND THE PSP CONTRACT

Under the BOT Law (R.A. 7718) and its IRR, NGAs/LGUs have the option to either conduct a public bidding (solicited track) or to entertain unsolicited proposals.

**Solicited.** The NGA/LGU prepares the documents and solicits bids from the private sector. Government provides the necessary support to enhance the viability of the project. This option ensures the implementation of

priority projects in the most expeditious manner.

**Unsolicited.** The private sector submits the proposal to the NGA/LGU concerned. No direct government guarantee, subsidies or equities are given. Further, as unsolicited bids usually involve only one proponent, the BOT Law requires an unsolicited proposal to undergo the Swiss challenge whereby government solicits

comparative proposals to challenge the original proponent. The terms of the challenger should compare with the original proponent's bid.

The PSP contract is a risk-sharing arrangement between government and the private sector, namely, financiers, developers and line agencies involved in the implementation of a project.

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# Deterrents to PSP in Public Infrastructure

During the discussions a number of perceived deterrents to PSP in public infrastructure emerged:

## *Government-related*

- Bureaucratic inertia or long delays in the processing of contracts.
- Because of government's pro-poor mandate, the pricing policies are "politically determined" (i.e., unrealistically low) such that they are unsustainable and make it difficult, if not impossible, to maintain the service. Sometimes, government has to absorb the losses.
- Lack of transparency
- Every bid has a specified floor and ceiling but these are inconsequential since some justifications are made to do away with them.
- Political intervention at the approval stage
- The BOT process rules seeming bias for the capitalists. Huge companies get better benefits compared to small businesses that may actually be providing more jobs or value added per unit capital.
- The BOT Authority's dual functions: as a regulatory agency it approves the contract, as a monitoring agency it oversees compliance to the contract.
- Graft and corruption.

## *Finance-related*

- High cost of submitting a proposal
- Projects' seeming inability to make money per specifications given.

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## << page 1 **SOLICITED VS UNSOLICITED**

Under the contract, contingent subsidies may become contingent liabilities in the course of a 20- to 25-year concession period. A contingent subsidy can be claimed from government when a change in the law adversely affects the contractor. Contingent liabilities, on the other hand, are risks assumed by government without incurring upfront fiscal cost. Payments are contingent on certain conditionalities that may occur during the life of the contract.

While generally, the provision of subsidy for any investment project should be economically justified i.e., private financial returns should exceed social returns and spillovers such as the generation of jobs, improvement of quality of life, etc. from the political standpoint, social returns must exceed private returns to justify government subsidies *ex ante*.

- High cost of financing, an infrastructure project's requiring a huge investment and its long gestation period. A BOT project requires equity from the proponent but usually the debt portion is bigger (60-40 or 70-30 debt-equity proportion). Moreover, the kinds of projects entered into are usually expensive because of the risks involved. Requirements are so high that only foreign firms are able to comply with them.
- Since loans for PSP projects are in foreign currency, the interest rate charged is affected by the credit rating of the country.
- The use of the country's sovereign resources and money as guarantees is not favored by some people in government.
- Guarantees are credit-driven and granted when the conditions are good. Thus, costs materialize because of unforeseeable events. Some multi-lateral agencies can provide guarantees but these are tantamount to sovereign guarantee.

## *Creditors and Funders*

- Although the ODAs charge low interest rates, in most ODA projects, the contractor comes from the country from which the ODA originates. Under such arrangements, the Filipinos become subcontractors.
- Per a study in the late 1990s, BOT-PSP is only favorable to countries that are better off or have good credit rating. That is, a rich country can dictate the credit rates and does not have to beg for credit from the financiers. Instead the financiers offer to give such countries credit.
- A private investor with enough capital will possibly not risk his own money and will, instead, leverage his equity by creating a special purpose vehicle (SPV) so that the risk is not against the balance sheet of the mother company but is covered by the SPV. When this happens, because the SPV entity does not have any borrowing record in the borrowing market, the lenders will require the new company to seek a guarantee from government. The requirement for government guarantee also exists because creditors are aware that while some companies may fold up, government is in perpetuity and can well assume the loan balance.

## *Incentives-related*

- Incentives for solicited projects: CSOs question the prudence of certain incentives meant to attract PSP in public infrastructure, e.g, lower or non-accountability to the public (in the case of IPPs)
- The private sector is mostly profit-driven; it does not have a pro-poor agenda.

## Observations

### *Matters of Procedure*

- There is no mention in the bill with regard to institutionalizing the budgeting and report format of monitoring.
- Under RA7718, the monitoring function is lodged in the BOT Center. The law however, does not define the monitoring role of the Center, and there is no financial appropriation for the said role. There is no mention in the bill that BOT should be the final repository of signed contracts.
- The law does not provide for who should compose the arbitration body. It does not specify a time frame for the completion of arbitration. Such information is usually contained in the contracts, but possibly, indicating them in the law will facilitate the faster movement of contracts.

### *Guarantees*

- The law is not clear on sovereignty guarantees.
- There are unsolicited proposals that garner guarantees.
- The DOJ makes the rulings on the guarantees.

## Recommendations

### *Incentives, rewards and penalties*

- The law should provide for a structuring of the incentives that are consistently desired: lower fiscal cost, reasonable pricing, reasonable quality and no corruption.
- A private sector proponent who can risk more of his capital should be provided more guarantees than a cautious private sector.
- Incentives, rewards and penalties for line agencies and developers that file claims should be stipulated in the BOT Law. The latter recourse may help make the sectors charged realize that there is a high cost for claims.
- Rewards must be given to projects with large social benefits.
- Government's issuance of penalties will make the private sector and government more conscious of the need to be accountable. A possible penalty for the agency is to disallow it from the submission of future bids.

## Transparency

- The law should provide for check and balance and transparency in the contract, transparency in terms of access to information, access to participation; and access to justice. Since the costs are carried by the public, requirements for transparency and accountability should apply to private investors.

### *Profits*

- A cap must be put on profit rates.

### *The citizenry*

- The Law should improve nationalist provisions and protect the people from too many risks assumed by the government.
- Strengthen the role of citizens.
- Make incentives pro-people.
- Give CSOs seats in policy formulation
- The law should have a provision such that in the event government is an ineffective regulator, the citizens may directly sue the proponents for not fulfilling their obligations as stipulated in the contract.

### *Matters of Procedure*

- The BOT Law should provide for the mechanics for the final stage of a project, be this with regard to its termination or transfer.
- The law should stipulate the accessibility of information to everyone during the project's entire cycle, through a website, for example.
- Strong regulation on the government side should correct whatever problems and abuses arise in the implementation of the project.

### *IRR*

- When the bill was being prepared, Congress indicated only the generic rates. During the consultations, it was suggested that the bill adopt specific hurdle rates.
- The bill must also cover the IRR; avoid having implementing rules and regulations after five years.

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### *Subsidies*

- The law should stipulate that there should be no direct subsidy. There should be a provision for a buy-out option for government.

### **Other Recommendations and Observations**

#### *Finance-related*

- There is a need to find a cheaper source of financing. The local capital market should be developed to avoid, or at least minimize, foreign currency risk. Some projects, however, require lump sum funding payable on a long-term basis. These requirements can only be provided by a foreign financing arrangement.
- Improve revenue collection from the project implementers. This will translate to fewer risks for the public as a whole and lower project costs.
- Suspending the granting of tax holidays will have a significant impact on government revenue as income tax holidays (ITH) are translated into all the corporate taxes in any given year.
- When a project is badly needed and the private sector does not want to invest in it because of the possibility of losses, then government is compelled to extend subsidy or guarantees to entice the private sector. Why not have insurance and surety companies provide the guarantee? In the absence of such, then the project may not be economically viable to justify the government guarantee.
- On the origination of the project: if the private sector has to borrow to launch the project, why does government partner with it? Why does government not undertake the project on its own?

### *Matters of Procedure*

- The DOJ should be made part of the approval process.
- Provide for more stringent requirements in the screening of projects. This can lower fiscal costs and at the same time attract better-quality bids and projects.
- Government should have good lawyers to deal with the private sector.
- There is no central repository of contracts; hence government cannot monitor the risks.
- As a regulator, government should be able to impose competitive balance in the business environment.
- Have private, credible, independent groups constitute a bigger group that would review and approve projects.

### *Bids*

- There should be more solicited bids.
- Agencies must be required to submit solicited bids and must be penalized if they fail to do so. If a particular agency insists on a particular project and if that project later on files claims with the government, then the said agency should be penalized.

### *Social costs and the environment*

- At the start of the origination of the proposal, there should be a way of accounting for the environmental and social costs like dislocation. Many times the review committee is aware of the social costs, but does not know how it should be accounted for.
- Include measures to impose discipline on stakeholders.
- Expenses incurred in research on social benefits must also be shared by the proponents and later on charged to the users.

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